

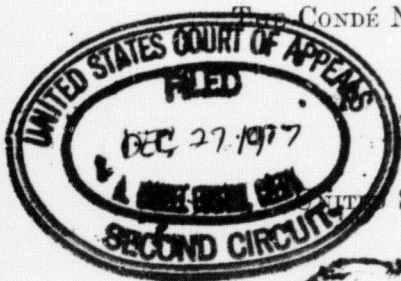
***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-6090

United States Court of Appeals
FOR THE SECOND CIRCUIT



THE CONDÉ NAST PUBLICATIONS INC.,

*Plaintiff-Appellee and
Cross-Appellant*

—against—

UNITED STATES OF AMERICA,

*Defendant-Appellant
and Cross-Appellee.*

B P/S

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR THE CONDÉ NAST
PUBLICATIONS INC.

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REPLY BRIEF FOR THE CONDÉ NAST PUBLICATIONS INC.

Preliminary Statement

Unintentionally, or otherwise, the Government's position in this Court tends to confuse and obfuscate. There is no need here to consider copyright cases, patent cases or abstract principles of trademark law in order to resolve the issues in accordance with applicable tax law. It is unnecessary to strain to fit the Stipulated Facts (J.A. 18-23)¹ into anything other than a business transaction with tax consequences. In cases dealing with the proper tax treatment to be afforded parties to a contract effecting a transfer of franchises, trademarks or tradenames, the nomenclature used in the contract becomes relatively unimportant. For tax purposes, a Court must be concerned with actualities rather than the refinement of title; its concern is with the substance, not the form. (*Leisure Dynamics, Inc. v. C.I.R.*, 494 F2d 1340, 1345 [8th Cir. 1974].)

Restatement of the Issue

The issue here is *not* whether the Vogue trademark is capable of being "sold" absent an assignment. The issue is *not* whether the transfer of the exclusive right to continue to use the Vogue trademark in the pattern business was a license. The issue is:

are the annual payments from Butterick to Nast in 1967 and 1968 *to be treated as* proceeds from the sale of a capital asset?

¹ Reference to pages in Joint Appendix.

Restatement of the Operative Facts

1. Prior to 1961 and continuing to the present, the "many valuable uses of [Nast's] Vogue trade name" (Gov't. Br. pp. 12, 23, 24)² were and are but *two* in number—in connection with Nast's VOGUE Magazine, and in connection with a separate paper pattern business.

2. In 1961, Nast sold its entire paper pattern business—including an exclusive license to continue the use of the name Vogue in connection with the business—to Butterick.

Butterick's "limited right to use the Vogue name" (Gov't. Br. pp. 10, 11, 18, 23, 24, 28, 30) is exclusive throughout the world in one of two industries in which the mark has achieved world-wide secondary meaning.

3. The purchase price for the 1961 sale consisted of a minor³ (13.6%) stock interest in Butterick and some cash, plus an annual payment of 1% of net sales of Butterick patterns.

4. Nast did *not* retain any interest in the use of the Vogue name in the pattern field. Nast did *not* retain and exercise a continuing operational interest in Butterick's business.

² Reference to pages in the Government's Main Brief.

³ Since the Government did not place in issue in the Court below that Nast received Butterick stock as part of the sales price, this matter is raised for the first time in this Court (Gov't. Br. pp. 3, 25-26). To appreciate the insignificance of the share ownership, this Court is asked to take judicial notice of the fact that Butterick management, in the person of Leonard Tingle and members of his family, owned 58% of the common stock at the time of the sale.

POINT I

In reply to certain of the Government's contentions.

A. That the Transfer was a License. (Gov't. Br. pp. 12-18, 23, 26-31)

There is no question but that Nast did in fact, as part of the Sales Agreement and so stipulated (J.A. 19), grant to Butterick in perpetuity

"the sole and exclusive right and license to use the trademark 'Vogue' in the United States, Canada, England and Australia, and, to the extent that Nast or its subsidiaries may lawfully do so, everywhere in the world, on patterns designed, manufactured and sold by Butterick and on pattern promotional material, subject to [certain] terms, conditions and limitations . . ."
(J.A. 65)

B. That *Cory v. Commissioner*, 230 F. 2d 941 (2d Cir. 1956) Applies to this Case. (Gov't. Br. pp. 12-14, 17-18, 23)

In *Cory*, this Court held that the 1942 grant of the exclusive right to publish the autobiography of Santayana in book form in the United States and Canada, in return for royalties measured by a percentage of the retail price of each book sold, did *not* constitute a sale, and the royalties did not constitute long-term capital gain.

The effect of *Cory*, at least in respect to the capital gain treatment attributable to royalties under similar circumstances, was negated by Revenue Ruling 60-226 (1960-1 C.B. 26) which held:

"the consideration received by a proprietor of a copy-right for a grant transferring the exclusive right to exploit the copyrighted work in a medium of publication throughout the life of the copyright shall be

treated as proceeds from a sale of property, regardless of whether the consideration received is measured by a percentage of the receipts from the sale, performance, exhibition, or publication of the copyrighted work, or is measured by the number of copies sold, performances given, or exhibitions made of the copyrighted work, or whether such receipts are payable over a period coterminous with the grantee's use of the copyrighted work."

This Revenue Ruling modified Revenue Ruling 54-409 (1954-2 C.B. 174) which had modified the 1933 ruling in I.T. 2735 (C.B. XII-2, 131).

Conceding that Revenue Ruling 60-226 precludes application of *Cory* to copyright licenses, the Government urges that this Ruling "should not be read as contradicting the application of *Cory* to the present trade name transfer." (Gov't. Br. p. 14 fn.) And why should this not be so read! Why, because in 1969, Congress "concluded in substance that the existence of royalty payments based upon use of a trade name *does* preclude capital gains treatment. See 26 U.S.C. § 1253 (b) (2) (F) and (c)." (Gov't. Br. p. 14 fn.) Of course, the Government is attempting in this Court, as it attempted in the Court below to apply the 1969 amendments to a 1961 transaction. As the Court below noted:

"The Court rejects the Government's contention that guidance can be found in the 1969 amendments to the Internal Revenue Code (26 U.S.C. § 1253). As the legislative history of this section makes clear, § 1253 changed the earlier case law, it did not codify it. S. Rep. No. 91-552, 91st Con., 1st Sess. 208." (J.A. 143)

In addition, the history of Revenue Ruling 60-226 indicates that *Cory* is not applicable to trademark licenses. In 1933, Internal Revenue determined that copyrights were incapable of division into separate properties and therefore

proceeds from the disposition of a copyright license constituted rentals or royalties subject to tax. (I.T. 2735, C.B. XII-2, 131). In 1954, Internal Revenue determined that for tax purposes a copyright was divisible into separate parts and if the consideration was not measured by a percentage of receipts from the sale, performance, exhibition or publication of the copyrighted work and is not payable periodically over a period generally coterminous with grantee's use of the copyrighted work, the consideration received by the copyright proprietor *is to be treated as* the proceeds of a sale of property. (Rev. Rul. 54-409 at 1954-2 C.B. 174). In reaching its determination that the prior 1933 ruling as to indivisibility of copyright should be modified, Internal Revenue stated:

"For the purposes of the Internal Revenue Code, a trademark may be divided, according to the usage of the market in which trademarks move, into separately salable fractions"

citing the *Seattle Brewing* and *Rainier Brewing* cases which are discussed hereinafter at Point II.

C. That Trademark Law Does Not Recognize the Divisibility of a Mark, and the Exclusive License of the Mark Cannot Qualify as a Transfer Entitled to Capital Gain Treatment. (Gov't. Br. pp. 14-18, 23, 27)

Undeterred by its own Revenue Ruling,⁴ affirmances by the 9th Circuit Court of Appeals⁵ and two acquiescences,⁶ the Government once again argues that principles of trademark law prevent recognition of a license as a transfer

⁴ Revenue Ruling 54-409, discussed in B. above.

⁵ *Seattle Brewing & Malting Co.*, 6 T.C. 856 (1946) *aff'd.* 165 F. 2d 216; *Rainier Brewing Co.*, 7 T.C. 162 (1946) *aff'd.* 165 F. 2d 217.

⁶ *Rose Marie Reid*, 26 T.C. 622 (1956) *acquiesced* 1956-2 C.B. 8; *United States Mineral Products Co.*, 52 T.C. 177 (1969) *acquiesced* 1969-2 C.B. xxv.

entitled to capital gain treatment. However, the nature of the transfer for trademark law purposes is of no moment; we are only concerned with the nature of the transfer *for tax purposes*. Technical property concepts are not controlling in matters of taxation. (*Grinnell Corporation v. United States*, 390 F. 2d 932, 948 (Ct. Cl. 1968).) Tax law recognizes the divisibility of the *uses* of the mark, via exclusive licenses, into separate salable fractions and does not require the separate sale or assignment of the entire mark in order that the transfer by exclusive license be *treated as* the sale of a capital asset.

D. With Respect to the Application of the "Leisure Dynamics" Test to the License Agreement Restrictions.
(Gov't. Br. pp. 11, 18-21, 24-29)

Assuming for purposes of argument, but without conceding, that the License Agreement should be considered separate and apart from the overall sale of Nast's pattern business to Butterick, the appropriate standard for consideration in this Circuit is not free from doubt. The "too restrictive" (Gov't. Br. p. 11 fn.) standard cited in Nast's Main Brief at pages 7-8 is the most recent reported appellate decision involving the taxable nature of trademark royalties, in which the Government contended that the royalties were capital in nature and should be treated as installment payments of the purchase price. (*Leisure Dynamics, Inc. v. C.I.R.*, 494 F. 2d 1340, 1343 [8th Cir. 1974].) This standard has evolved from conflicting appellate resolutions of the *Dairy Queen* franchise cases (Gov't. Br. pp. 8-9 fn.) but was *not* applied by the Court below.

The Government would have this Court apply the test used by the Tax Court in *Leisure Dynamics*, which test was used by Judge Cannella below in finding that—for tax purposes—the transfer should be treated as a sale (J.A. 143):

Did Nast retain a substantial right in the transferred asset or continue to participate in transferee's business? (Gov't. Br. p. 11)

As discussed at pages 17-21, Nast did not retain a substantial right in the asset or participate in Butterick's business. The annual payments should be treated as sale proceeds under either test.

E. That Nast Had Initially Treated the Butterick Payments as Ordinary Income. (Gov't. Br. pp. 27-28)

It is Stipulated Fact #12 (J.A. 22) that for the years prior to 1967 (1963, 1964, 1965 and 1966) Nast treated the annual Butterick payments as ordinary income for federal income tax purposes. However, this fact is neutral on the issue of whether the license effected a sale for tax purposes of the right to use the mark Vogue in the pattern business. (See, *First National Bank of Princeton v. U.S.*, 136 F. Supp. 818 [D.C.N.J. 1955].)

As in *First National Bank*, the fact that Nast mistakenly treated the Butterick payments as ordinary income is of no more consequence under tax law than if Nast had originally treated all payments as capital gains qualified for § 1201 treatment. The treatment by Nast of these payments prior to 1967—closed years for which Nast may not now seek redress—does not require, or even suggest, a determination that this arrangement was anything but a sale of the right to use the trademark Vogue in the pattern business purchased by Butterick from Nast.

POINT II

The sale of the Vogue pattern business as a going concern and the grant to Butterick of the right to continue use of the Vogue name constituted the sale of a capital asset; the monies received annually from Butterick should be treated as the proceeds of a sale.

To determine the proper tax treatment to be given the transaction consummated by Nast and Butterick in 1961, it is enough to consider the existing law as applied to similar factual situations in *Seattle Brewing & Malting Co.*, 6 T.C.

856 (1946), aff'd. 165 F. 2d 216 (9th Cir. 1948), its companion case, *Rainier Brewing Co.*, 7 T.C. 162 (1946), aff'd. 165 F. 2d 217 (9th Cir. 1948), *United States Mineral Products Co.*, 52 T.C. 177, *acquiesced* 1969-2 C.B. xxv, and *Rose Marie Reid*, 26 T.C. 622, *acquiesced* 1956-2 C.B. 8, together with the cases cited therein.

In *Seattle Brewing* and *Rainier Brewing*, Seattle and Rainier entered into an agreement divided into three parts headed "Purchase Agreement", "Licensing Agreement" and "Miscellaneous Provisions".

"The purchase agreement provided for the purchase of certain real property in or adjacent to the city of Seattle, Washington, including the old brewery then dismantled and used as a cold storage plant and warehouse, together with certain specified personal property, including beer containers, cardboard cases, beer on hand, and office fixtures and equipment. Under the licensing agreement Rainier granted to petitioner, its successors, and permitted assigns 'the sole and exclusive perpetual right to license' to market and manufacture alcoholic malt beverages within the State of Washington, and the Territory of Alaska under its trade names and brands 'Rainier' and 'Tacoma', together with the right to use within the territory any and all copyrights, trade marks, labels, or other advertising media adopted or used by the grantor in connection with its beer, ale, or other alcoholic malt beverages. The consideration for this grant was to be determined at least during the first five years on the barrelage basis, i.e., a specified amount for each barrel of alcoholic malt beverage sold or distributed within the territory, payable annually. There was also a provision for a minimum annual royalty of \$75,000 and a provision for the reduction of the minimum royalty in the event of local option in a part of the territory covered by the agreement, or governmental action pre-

venting the manufacture and sale of alcoholic malt beverages in the assigned territory." (6 T.C. at 865)

In finding that the license of the use of the name "Rainier" in two Western states and the Territory of Alaska constituted sale of a capital asset for tax purposes, the Tax Court held:

"The mere fact that there was a payment of \$1,000,000 in a lump sum is not in itself determinative whether the transaction was a license or a sale. . . . We must look to the extent of the rights granted and the finality of the grant. It is the nature of the transaction that is the controlling factor." (6 T.C. at 867)

"The right to use a trade name is a monopoly, as is a copyright or a patent. It carries with it the right to control its use in connection with a manufactured article and to prevent any competition that might destroy its value. It is a property right and the trade name is property, no less so because it is intangible. The right of alienation is one of the essential incidents of a right of property. Whatever right the owner may have to protect the control over the trade name beyond his own sales must depend upon agreement. He can not divide his property in the name, but he may assign or transfer a property right thereto by grant in a limited territory. If such grant is exclusive and perpetual, its characteristics more resemble a sale than a license, and this is particularly true where all the consideration has been paid. In *Goldsmith v. Commissioner, supra*, Judge L. Hand said 'It does not unduly strain the meaning of a sale to make it include an exclusive license.'

"It is true under this agreement that petitioner could not assign the rights granted to it without the consent of Rainier, but we do not regard this provision as controlling here. Neither could Rainier assign the right to another or use it itself. The exclusive grant to peti-

tioner resulted in the retention by Rainier of the naked legal title in the interest granted for the benefit of the grantee. Moreover, by the grant of an exclusive right and the agreement not to compete, Rainier transferred to petitioner its business in alcoholic malt beverages sold under the trade name in the limited territory." (6 T.C. at 868-869)

As in the case of the sale of the entire Vogue Pattern business to Butterick, the Court noted:

"As we interpret the contract here in question, it was obviously the intention of the parties that Rainier grant to petitioner all of the right which it had to use the trade names 'Rainier' and 'Tacoma' in the manufacture and sale of alcoholic malt beverages in the State of Washington and the Territory of Alaska. It was also the intention of the parties that this grant was to be exclusive not only as to third parties, but as to Rainier itself. We know of no reason why one who is the owner of the right to use a trade name may not grant to another its exclusive use in a limited territory for all future time upon the payment of a price. Cf. *Coca-Cola Bottling Co. v. Coca-Cola Co.*, *supra*. Such a grant, while not disposing of the entire property in the grantor, is the equivalent of such disposition within the limited territory granted. Clearly such a grant would be a capital transaction and the amount paid by the grantee could not be exhausted because it was perpetual." (6 T.C. at 873)

In *United States Mineral Products Co.*, 52 T.C. 177 (1969), petitioner was a New Jersey corporation engaged in the manufacture and marketing of mineral wool based products, under the trade name CAFCO, for insulation, fireproofing and acoustical treatment.

In 1958 petitioner organized a Canadian subsidiary, CAFCAN, to manufacture CAFCO insulation materials in

Canada from the "basic element" manufactured by petitioner and sold to CAFCAN to be mixed with rock wool and asbestos to form the final products. CAFCAN paid petitioner 3¢ for every pound of CAFCO product it mixed.

In September, 1960, petitioner and CAFCAN executed an agreement dated March 16, 1959, which granted to CAFCAN:

"the following exclusive rights, licenses and privileges, to be exercised solely within the territorial limits of Canada, and subject only to the conditions set forth in this agreement.

(a) To manufacture, use and sell, and to grant to others such licenses to manufacture, use and sell, products embodying the inventions described in the patents listed on Schedule 1 annexed hereto; and

(b) to use and to grant to others the right and privilege to use the trademarks listed on Schedule 1 annexed hereto; . . .

"In return, CAFCAN agreed to pay petitioner quarter-annually 3 cents per pound of blended fibers mixed by it. . . . The trademarks referred to in the agreement consisted of one issued Canadian trademark (CAFCO) and three Canadian trademark applications (Sound Shield, Blaze-Shield, and Heat-Shield) which were issued in October and December 1960." (52 T.C. at 188)

"The exclusive grant of rights, licenses, and privileges under the Canadian agreement was to remain effective for the periods during which the various patents and trademarks were in force unless sooner terminated by petitioner as a result of CAFCAN's default in the performance of any of its obligations. Petitioner could terminate CAFCAN's rights upon 30 days' notice if CAFCAN's remittance to petitioner for any year totaled less than \$5,000, or if CAFCAN became insolvent. CAFCAN covenanted to keep com-

plete books and records of the accounts of its business and to make periodic reports to petitioner." (52 T.C. at 189)

The Tax Court held that the income to petitioner from CAFCAN was taxable partly as ordinary income and partly income eligible for capital gains treatment:

"In essence, what we have here is the transfer of a going business in Canada carried on by a U.S. corporation with the marketing aid of a Canadian distributor to a wholly owned Canadian subsidiary formed for the purpose of carrying on the entire operation within the bounds of Canada. We decline, however, to treat the business as a single asset and determine whether it is essentially capital in nature, as petitioner would have us do, but instead we shall categorize the various assets transferred and determine their taxable nature individually." (52 T.C. at 193)

The Court found that to the extent that the income was consideration for the transfer of petitioner's rights in the Kempthorne patents, this income was royalty income and the balance of the rights constituted consideration paid for the capital assets transferred:

"The second category of assets transferred under the Canadian agreement consisted of the Canadian trademark and trademark applications, the exclusive use of which was granted to CAFCAN for all of Canada for the lives of the trademarks. The common-law right to prevent unfair competition and the statutory right permanently to exclude others from the use of a registered name certainly are valuable property rights which may be assigned. Those rights with respect to the names referred to in the Canadian agreement constituted capital assets which were sold under the agreement. *Seattle Brewing & Malting Co.*, 6 T.C. 856 (1946), *affd.* 165 F. 2d 216 (C.A. 9, 1948); see also

Norwich Pharmacal Co., 30 B.T.A. 326 (1934)." (52 T.C. at 196)

Then, finding that the Kempthorne patents were not important to the deal between petitioner and CAFCAN, the Court held:

"We conclude on this record that the entire 3 cents per pound constitutes consideration paid for the sale of capital assets and section 1231 assets owned by petitioner." (52 T.C. at 200)

Here, Nast is in practically the same position as *Rainier Brewing Co.* and *U.S. Mineral Products*. The success of the businesses sold depended on the continued use of the trademark in connection with the business; and the buyers paid a purchase price for the business based on future sales by the business. The only distinction between the sales arrangements is that Nast gave Butterick *world-wide* rights to use the "Vogue" trademark in the pattern industry, whereas the "Rainier" mark was restricted to three states and the "CAFSCO" mark to a single country. Butterick purchased greater rights in the "Vogue" mark and, as in *Rainier* and *U.S. Mineral Products*, the purchase price for these rights should also be taxed pursuant to I.R.C. § 1201.

Perhaps in a factual—though not legal—sense the fashion-related facts in *Rose Marie Reid*, 26 T.C. 622 (1956), are more analogous to the instant case than are trademarks in the beer and insulation industries. Rose Marie Reid was the designer and manufacturer of female swimsuits who received national and international publicity from the use of her suits by female swimmers in the British Empire Games in Australia in 1937. In 1938 she formed a Canadian corporation to manufacture and sell her swimsuits. This corporation had immediate success with annual sales growing from \$32,000 in 1938 to \$834,000 in 1946. In 1946, with a partner, Kessler, she

formed a California corporation to manufacture and sell bathing suits in the United States.

In 1949, Miss Reid became disenchanted with her business relationship with Kessler and threatened to rescind the right of the California corporation to use her name in connection with swimsuits. This threatened litigation was resolved by an Agreement of Settlement in April of 1949 which provided:

"1. Corporate Name and Design Patents.

Reid hereby grants to the corporation the exclusive and continuing right to use her name as its corporate name in the United States of America, and to allow the corporation the right, exclusive in the United States of America, to utilize her design patents and/or process patents, now existing or hereafter obtained, in the manufacture and sale of the corporation's products. In consideration thereof the corporation agrees to pay to Reid, her heirs, executors, administrators and assigns an annual royalty which shall be equal to one per cent of the corporation's net sales for each year commencing September 1, 1948. This royalty shall not be diminished by the expiration or judicially determined invalidity of any such patent or patents, and the obligation to pay such royalty shall continue so long as the corporation continues to do business in the said name or under any name similar thereto, and shall likewise continue as an obligation of any person, firm or corporation to whom the business of the corporation or a substantial part thereof shall be sold or transferred and which shall use said name as a trademark or corporate name. This paragraph shall be severable from and independent of any provision of this contract hereinafter set forth." (26 T.C. at 628)

The Tax Court held that the 1% annual royalties received by Reid were received as part of the purchase price

of capital assets and were taxable to Reid as capital gains. The Court noted that the 1949 Agreement was a complete assignment to the California corporation of the exclusive right to use petitioner's name and patents throughout the United States for the full period of their existence. In addition, the Court dealt with a matter of California law that a tradename may not be sold separately from the business.

"California rules respecting the transfer of a trade name cannot change the nature of the payments into payments for services for Federal income tax purposes, when they were not in fact made for services rendered. Whatever the defects or incapacities of such transfer . . . we are convinced that she received the payments in respect of such transfer, and not for personal services." (26 T.C. at 634)

In both cases, a recognized name—one in swimsuits and the other in patterns—was transferred to a corporation in partial exchange for 1% of the corporation's net sales in each year.

"An exclusive perpetual grant of the use of a trade name, even within narrower territorial limits than the entire United States, is a disposition of such trade name falling within the 'sale or exchange' requirements of the capital gains provisions of the 1939 Code. . . .

Even the fact that an agreement may be termed a 'license' or the parties thereto 'licensor' and 'licensee' has been denied determinative effect. . . .

And finally, payment for the transfer need not be in the form of a lump sum in order to constitute capital gain, but may take the form of a percentage of sales or profits, or an amount per unit manufactured or sold, or any combination of the foregoing." (26 T.C. at 632)

POINT III

Considering the License Agreement separate and apart from the Sales Agreement, the License Agreement constitutes, for tax purposes, the sale of a capital asset.

The parties to this proceeding have conceded that Nast and Butterick devised the exclusive license *as part of the total Sales Agreement*,⁷ and Nast contends that the annual payments *should be treated as capital gains* as noted in Point II *supra*. Even if the exclusive license is considered independently of the Sales Agreement, the severance of the use of the mark Vogue into its separate industries and the grant of perpetual exclusive world-wide rights to the continued use of the mark Vogue in the pattern industry was a sufficient transfer of rights to qualify as the sale of a capital asset for tax purposes.

The License Agreement has been reviewed⁸ by the Court below and has been found to transfer sufficient rights to qualify the annual payments as sales proceeds. The li-

⁷ "An essential element of the sale was the right of Butterick to continue use of the name 'Vogue' in conjunction with the pattern business. No Sales Agreement would have been executed by Butterick if it did not have the right to use the Vogue name in connection with the pattern business purchased from Condé Nast." (J.A. 19)

⁸ The Government urges several grounds why this Court should not apply the "clearly erroneous" rule to the Determination below, chief of which is that the determination of a sale is a question of law rather than fact (Gov't. Br. p. 10). The Government would like a *de novo* review in this Court, but it does not cite as error any portion of the District Court's detailed analysis of the License Agreement (J.A. 138-143), nor does it take issue with any of Judge Cannella's factual determinations indicated at pages 5-6 of Nast's Main Brief. Surely to be entitled to the scope of review requested, the Government should assert some type of error in the underpinnings of the Determination below rather than merely register dissatisfaction with the result!

cense restrictions did not constitute retention of "a substantial right in the transferred asset" or involvement or participation in Butterick's business. (J.A. 151-152)

Before considering the nature of the License restrictions, the elements of the *Leisure Dynamics* test—in either the Tax Court or the 8th Circuit Court of Appeals—should be defined with respect to the Stipulated Facts.

A. What was the "transferred asset"?

As has been noted at length in the Government's Brief, there was no transfer, nor attempted transfer, of the Vogue trademark. In 1961, 1967 and today, Nast was and is the registered proprietor of the mark Vogue. However, after the 1961 sale to Butterick, Nast's *rights of use* of the mark were eliminated, and Butterick's rights of use of the mark were created, in the pattern business. In view of this flow of rights from Nast to Butterick with respect to the use of the name Vogue in the pattern business—a readily identifiable product market—the only asset capable of being transferred here was the perpetual exclusive right to continue to use the name Vogue in the pattern business. That this was a valuable asset, or "salable fraction", is clear from Stipulated Fact #3 (J.A. 19) that there would be no sale without this right.

B. What was the "transferee's business"?

In all but a few of the reported cases involving the tax consequences flowing from the transfer of a trademark in connection with the sale of a business, the seller and buyer were in the same business and the buyer was acquiring a portion of the seller's geographic territory. There arose a certain amount of interdependence in which transferor continued to participate in the operations of the transferee's business in order that the transferor's business not be adversely affected. In the *Dairy Queen* cases, much court analysis was devoted to a consideration of whether

the license restrictions were a legitimate protection of seller's remaining ice cream business or continued participation in the transferred ice cream business.

Here there was, and is, no problem in differentiating between Nast's and Butterick's businesses—one publishes fashion magazines, the other produces paper patterns. The subject of transferee's business must be the production, distribution and sale of patterns.

C. What provision of the License Agreement

- 1. constitutes a retention of a substantial right to the exclusive world-wide use of the mark Vogue in the pattern business, or**
- 2. makes Nast an active participant in Butterick's pattern business?**

In this action Nast and the Government have indicated those sections of the License Agreement in which it could be argued that Nast "retained an interest" in Butterick's use of the mark "Vogue" (Stip. #9). As to those sections, it was stipulated that:

(a) Nast never exercised any interest in Butterick's use of the mark in the pattern business; and

(b) the primary purpose of the indicated sections "was to preserve the value and reputation of the 'Vogue' tradename". (J.A. 21-2)

It is submitted that there is nothing in these Sections of the License Agreement or any part of the License or Sales Agreement, which suggests or indicates that Nast retained, held back, or was in any way interested in recovering, any portion of its money-losing pattern business.

Throughout this entire transaction, there was one paramount consideration: although Nast had to grant Butterick the perpetual exclusive world-wide right to continue to use the Vogue mark in the pattern business, such use by But-

terick, its assignee or licensee should not adversely reflect on VOGUE Magazine. This the Court below so found:

"From an overall perspective it can be seen that Nast bargained for and received numerous contractual provisions, the primary purposes of which were 'to preserve the value and reputation of the "Vogue" tradename.' (Stipulation at 4). Their purpose in protecting the Vogue name was, however, far more than an attempt to guarantee that Butterick would be able to make payments to Nast. The purpose, as becomes evident after a close reading of the License Agreement, was to assure . . . the name Vogue, which Nast still owned and used in the magazine field, would be associated only with high quality merchandise marketed in a manner befitting its top-of-the-line status. See *Condé Nast Publications v. Vogue School of Fashion Modeling*, 105 F. Supp. 325 (S.D.N.Y. 1952). The Court finds that each and every provision of the License Agreement which restricts Butterick's use of the Vogue name was intended primarily to protect the value and reputation of the Vogue name for its use by Nast in the publication of Vogue Magazine." (J.A. 142-3)

The Government has seen fit to argue that Nast's retention of its right to use the mark Vogue in the magazine business is sufficient to deny effect to the sale of the right to use the mark Vogue in the pattern business. The Government does not challenge the factual underpinnings of the Determination below that Nast did not retain an interest in the pattern business. Without debating the scope of review available to this Court as to the ultimate determination below, or as to the application of the "clearly erroneous" rule to the findings of fact of the Court below with respect to the license limitations, great weight should be given these findings of fact when they remain unchallenged by the Government.

Analysis of the District Court

Upon submission of the case on Stipulated Issues (J.A. 16), Facts (J.A. 18-23) and Exhibits (J.A. 24-134) with copious briefs, the District Court considered each License provision⁹ cited by the Government as indicating less than a full transfer from Nast to Butterick of the right to use the mark Vogue in the pattern business. Slightly more than one year after the submission of the case and main briefs, the Decision (J.A. 135) was handed down. The quality control, termination and alienability provisions were analyzed and compared to similar provisions in the *Dairy Queen* and other cases.

With respect to the quality control provisions the Court below found:

"Nast retained no continuing right to participate in Butterick's business. Rather, Nast retained only a right to inspect. As to the quality control provisions, the agreement specified that when using the Vogue name, Butterick had to adhere to those standards previously utilized by Nast and when the Vogue name was used in conjunction with Butterick's, the material had to be at least equal in quality to material previously marketed by Butterick. Thus, Butterick knew the standard to which it had to conform. These provisions are analogous to those found in the *Dairy Queen* 'ten paragraph agreement' which the Ninth Circuit found did not contain restrictions substantial enough to render the transaction a license rather than a sale." (J.A. 149-50)

With respect to the termination provisions, the Court below found:

"As to termination, the instant agreement is silent as to Nast's recourse if Butterick fails to abide by the

⁹ Sections 1, 2, 3, 6, 10(d) and 11(a). (Stipulation #9, J.A. 21).

quality standards. Unlike the Dairy Queen contracts considered by the Tenth, Fifth, Eighth and Ninth Circuits, there is no provision in the License Agreement which permits Nast to terminate either with or without notice if Butterick fails to maintain the agreed-upon standards. In this respect the License Agreement is similar to the 'ten paragraph agreement' (see 35 T.C. 773, 776-77 (1961)) which the Ninth Circuit held to be a sale, and includes a restraint less substantial than that considered by the Dairy Queen courts." (J.A. 150)

With respect to the alienability provisions, the Court below found:

"As to alienability, the contracts considered by the Tenth, Fourth, Fifth and Eighth Circuits and three of those considered by the Ninth Circuit prohibited transfer without prior approval. The License Agreement, however, while requiring Nast's consent prior to any transfer by Butterick, specifically provides that such consent shall not be unreasonably withheld unless the proposed assignee is involved in the fashion magazine business, or does not coincidentally purchase Butterick's pattern business. In the latter two circumstances Nast has an absolute right to withhold consent to the transfer." (J.A. 150-51)

The Government has not quarreled with, much less cited as error, the above analysis but only with the following conclusion:

"Thus, in light of the fact that the circuits which have considered an analogous situation have found sales in contracts containing greater restrictions upon the purchaser's exercise of his purchased rights, this Court concludes that, based upon the terms of the License Agreement, a sale occurred in the instant case." (J.A. 151)

It is respectfully submitted, that the Government:

(a) having relied upon the *Seattle Brewing* and *Rainier Brewing* cases to establish the proposition that a trademark is divisible into separate salable fractions (Rev. Rul. 54-409 *supra*);

(b) having acquiesced in *Rose Marie Reid*, 1956-2 C.B. 8, *supra*;

(c) having successfully taken the position in the Tax Court that the "Gumby" license in *Leisure Dynamics* should be treated as a sale of the trademark (32 T.C.M. 159), *supra*; and

(d) having accepted, or at least not having excepted to, the factual underpinnings below;

it is improper for the Government to ask this Court to reverse and dismiss solely because it doesn't like the result. Affirmance here will not lead to an imagined raid on the fisc (Gov't. Br. p. 30). There will be no adverse effect upon tax revenues, since it can be safely assumed that the Government will, and probably has, rejected any claim of Butterick that payments to Nast qualify as a cost-of-business deduction. (The actual effect on federal revenues will be an increase of approximately 23%.) This case will not affect post-1969 transactions which will be governed by 26 U.S.C. 1253.

In short, the Government has indicated no error below, or submitted a valid public policy reason, to persuade this Court that the grant of the perpetual exclusive world-wide right to use the mark Vogue in the pattern business should not be treated as the sale of a capital asset. In addition, it should be noted that the Government has not chosen to controvert the proposition in Point II of Nast's Main Brief that *all* of the annual payments *should be treated as* the proceeds of a sale, in the event that the transfer was tantamount to a sale as determined below.

Conclusion

The District Court properly determined that Nast sold its right to use the mark Vogue in the pattern business, but that Court erred in not treating all of the annual payments from Butterick as proceeds of that sale. The judgment and amended judgment of the District Court should be vacated and this matter remanded to the District Court with instructions to enter judgment in the amount demanded in the Complaint together with applicable interest and costs of this appeal.

Respectfully submitted,

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(62424)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

-----X
THE CONDE NAST PUBLICATIONS INC.,:

Plaintiff-Appellee and
Cross-Appellant

-against-

UNITED STATES OF AMERICA

Defendant-Appellant
and Cross-Appellee.

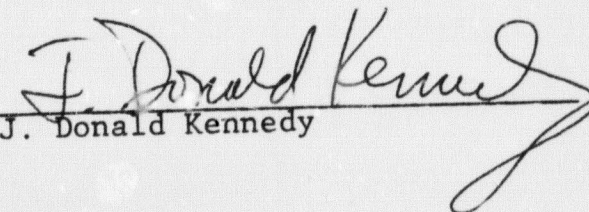
Docket Number
77-6090

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STATE OF NEW YORK)ss.:
COUNTY OF NEW YORK)

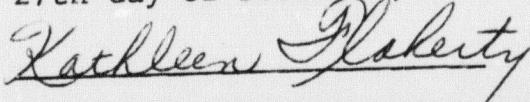
J. DONALD KENNEDY, being duly sworn,
deposes and says.

1. Deponent is not a party to the above-entitled action, is over 18 years of age, and resides at 511 East Chester Street, Long Beach, New York.

2. On December 27, 1977, deponent served four (4) copies of the Reply Brief of The Conde Nast Publications Inc. in connection with the above appeal upon the Office of the United States Attorney for the Southern District of New York, by personally delivering same to said office, with attention to William G. Ballaine, Assistant United States Attorney.


J. Donald Kennedy

Sworn to before me this
27th day of December, 1977



KATHLEEN FLAHERTY
Notary Public, State of New York
No. 31-4523952
Qualified in New York County
Commission Expires March 30, 1978